



GSA Office of Governmentwide Policy

MEMORANDUM FOR RONALD POUSSARD

DIRECTOR

DEFENSE ACQUISITION REGULATIONS COUNCIL

FROM:

RODNEY P. LANTIER, DIRECTOR Kochny P. Canthe

REGULATORY AND FEDERAL ASSISTANCE

PUBLICATIONS DIVISION

SUBJECT:

FAR Case 2002-008, Gains and Losses, Maintenance and

Repair Costs, and Material Costs

Attached are comments received on the subject FAR case published at 68 FR 40466; July 7, 2003; The comment closing date was September 5, 2003.

Response Number	<u>Date</u> <u>Received</u>	Comment Date	Commenter
2002-008-1	08/25/03	08/25/03	NDIA
2002-008-2	09/05/03	09/05/03	ABA
2002-008-3	09/08/03	09/08/03	AIA
Attachments			

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2002-008-1

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The Voice of the Industrial Base

August 25, 2003

General Services Administration The FAR Secretariat (MVA) 1800 F Street, NW, Room 4035 ATTN: Laurie Duarte Washington, DC 20405

FAR Case 2002-008

Dear Ms. Duarte:

The National Defense Industrial Association (NDIA) appreciates the opportunity to provide comments on the proposed amendments to the Federal Acquisition Regulation (FAR) cost principles as set forth in FAR Case 2002-008.

NDIA is a non-partisan, non-profit organization with a membership that includes over 1,100 companies and more than 27,000 individuals. NDIA has a specific interest in government policies and practices concerning the government's acquisition of goods and services, including research and development, procurement, and logistics support. Our members, who provide a wide array of goods and services to the government, include some of the nation's largest defense contractors.

Our comments on the proposed amendments are provided in the following paragraphs.

FAR 31.205-24, Maintenance and Repair Costs. We agree that this cost principle can be removed from the FAR.

FAR 31.205-26, Material Costs. We also agree with the deletion of the wording as proposed because we concur that generally accepted accounting principles adequately cover this topic.

FAR 31.205-16, Gains and Losses on Disposition or Impairment of Depreciable Property or Other Capital Assets. We believe that subparagraph (b) of the proposed amendment is unnecessary, not reflective of the reality of the business decisions, inequitable and not in the interest of either the government or the contractor.

1. Necessity for Provision. The term disposition means just that—the proposed FAR definition of the term in subparagraph (b)(2) is unnecessary and could be confusing.

Redefining a commonly understood word to achieve an end result of dubious value is likely to create disputes in the application of this cost principle.

2. Nature of the Business Decisions. The disposition of an asset involves a business decision and the leasing of an asset generally involves a separate business decision. When the decision is to dispose of an asset, a second decision is necessary as to if and how to replace that asset. Replacement could be accomplished through purchase of a new or used asset, lease of a different asset or lease of the disposed asset. The calculation of a gain or loss should not be impacted by the mere fact that the contractor formerly had an ownership interest in that asset and elects to continue the use of that asset through other than ownership.

3. Equity. Extension of the disposition date beyond the common language use of the term disposition is inequitable because (1) the government would "recoup" gains from a contractor who does not obtain a gain and (2) the government could be entitled to a gain of less than the amount of the gain actually realized by the contractor.

To illustrate point (1), assume the following facts: A contractor enters into a sale and leaseback for a building. The building purchase price was \$40 million and the building had an estimated life of 40 years at the time of purchase. The building has been depreciated on a straight-line basis for 20 years. The book value of the building is thus \$20 million (\$1 million of allowable depreciation cost per year). The contractor sells the building for \$30 million and leases it back for five (5) years at a market rate of \$2 million per year (or \$1 million per year greater than the depreciation cost the contractor would have incurred if it retained ownership) with an option to renew for another five years at market price. At the end the first five-year lease, the contractor moves out. At that point the building is worth \$35 million.

As the amendment is proposed, the additional \$1 million per year in lease costs is not recoverable on government contracts. The FAR defined gain on the building would be \$35 million (the value on the FAR defined disposition date, i.e. when the contractor moves out) less \$15 million (\$20 million book value on the sale/leaseback transaction date less \$5 million in imputed depreciation during the 5-year lease). The government then shares in a \$20 million gain, although the contractor's gain as of the actual disposition date was only \$10 million (the proceeds on the actual disposition date less the book value). Furthermore, because the contractor would incur an additional \$5 million of unallowable leasing costs during the 5-year lease, the actual gain for the contractor is \$5 million less because of the sale-leaseback provisions.

For point (2), using the same basic facts, change the assumption of the market price at the end of the 5-year lease to \$15 million. The FAR defined gain on the building would be \$15 million (the value on the FAR defined disposition date, i.e. when the contractor moves out) less \$15 million (\$20 million book value on the sale/leaseback transaction date less \$5 million in imputed depreciation during the 5-year lease). There is no gain or loss, even though the contractor has netted \$5 million on the transaction (original gain of \$10 million less \$5 million in increased lease costs.

Clearly, it is not equitable for the government to share in additional gains after the date of actual contractor disposition or to recoup a greater or a lesser gain due to events after the date of actual disposition that have no real effect on the contractor's actual gain or loss. The objective for the government should be to obtain a share of the gain that the contractor actually has realized—not some amount that includes gains or losses that, in fact, the contractor has no right to, and will not, receive.

Calculating the recognition of gain based on the value of the building when the contractor finally vacates is also likely to lead to considerable confusion and controversy in cases where the contractor continues to occupy the building for an extended period. What happens if the new owner/landlord makes substantial improvements in the property that increase its value substantially during the leaseback period? That is a common occurrence. In fact, some sale and leaseback transactions are motivated primarily by the landlord's promise to make such investments if the seller will agree to stay as a tenant. For companies that do not have enough ready capital to make needed improvements themselves, a sale and leaseback may be the only way to renovate a building that has become obsolete and uneconomical. Under the regulation as proposed, contractors would be penalized at the end of the lease period – perhaps 20 or 30 years later — for several rounds of landlord improvements that increased the value of the building. That outcome makes no sense and it would be very difficult to determine what the fair market value for a building would have been without the improvements 20 or 30 years later.

4. Mutual Benefit. A provision that is imprudently worded could encourage contractors to make business decisions that are not mutually beneficial to either party.

For example, if the allowability of facility costs were to be impacted by the fact that a contractor formerly had an ownership interest in that facility, contactors would be encouraged to expend additional (allowable) costs to relocate to a non-formerly owned facility in order to be able to recoup their full expenditure for leasing.

5. Other Considerations. Illogical rules can lead to seemingly unproductive actions just to avoid the consequences of an illogical rule. As pointed out above, a contractor might be encouraged to incur a larger amount of allowable costs just to assure recovery of its legitimate expenditures.

It is not always going to be clear when a contractor has finally vacated a facility. If the contractor is selling the building because its business is declining, it may well want to lease substantially less space than it occupied as the owner. How much space does the contractor have to vacate before it is required (or permitted) to recognize a gain or loss? Can the contractor retain a very small presence in the facility and continue to postpone recognition of a gain forever? Should the trigger for recognition of gain be different if the contraction in need for space is solely the result of declining business rather than a voluntary decision by the contractor? The opportunities for confusion and dispute are endless.

Another question is how long does a contractor have to "vacate" a property to avoid application of the sale/leaseback provisions? Could a contractor "vacate" a sold property for one day and then sign a lease for the same property starting the next day? Do the sale/leaseback provisions pertain in this circumstance? If the answer is no, this would appear to be a "loophole." If the answer is yes, just how long must a contractor have vacated the property in order to preclude classification as a sale/leaseback?

Contractor access to the records of a buyer could be a problem. Because this provision requires knowledge of the ultimate sales price, a contractor may not have access to such data in order to apply the provision as written.

6. Our Recommendation. We agree that the cost principle as currently drafted is ambiguous and needs to be clarified, but it seems to us that the solution is much easier than the convoluted and fundamentally irrational calculation that is proposed. The simple solution is to require a contractor to recognize a gain or loss on a sale and leaseback transaction immediately. If the contractor has realized a gain, the contractor should be required to share that gain immediately with the government, as the regulation requires. In exchange for sharing the gain immediately, the contractor should be permitted to recover as an allowable cost the reasonable rent it pays on a replacement facility, without regard to whether that replacement facility is the same facility the contractor just sold or a different facility.

Again, we appreciate this opportunity to provide input regarding the proposed amendments. The Council is to be commended for sincere and productive efforts to streamline the cost principles. If you have any questions, or need additional information, please contact NDIA Procurement Director Ruth Franklin at (703) 247-2598 or at rfranklin@ndia.org.

Sincerely,

Poken Stage

Peter M. Steffes

Vice President, Government Policy

Defending Liberty **Pursuing Justice**

2002-2003

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September 5, 2003

General Services Administration FAR Secretariat (MVA) Attention: Ms. Laurie Duarte Room 4035 1800 F Street, N.W. Washington, D.C. 20405

Re: FAR Case 2002-008:

Proposed Rule: Gains and Losses (FAR 31.205-16);

68 Fed. Reg. 40466, July 7, 2003

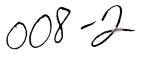
Dear Ms. Duarte:

On behalf of the Section of Public Contract Law of the American Bar Association ("the Section"), I am submitting comments on the above-referenced matter. The Section consists of attorneys and associated professionals in private practice, industry, and government service. The Section's governing Council and substantive committees contain members representing these three segments to ensure that all points of view are considered. In this manner, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.

The Section is authorized to submit comments on acquisition regulations under special authority granted by the Association's Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, therefore, should not be construed as representing the policy of the American Bar Association.

Introduction

FAR Case 2002-008 proposes to amend FAR 31.205-16, "Gains and losses on disposition or impairment of depreciable property or other capital assets," by adding a rule addressing how and when a gain or loss is determined in a sale and leaseback transaction. The proposal would define the date of disposition in such a transaction to FAR Secretariat (MVA) Attention: Ms. Laurie Duarte September 5, 2003 Page 2



be the *later* of "[t]he latest ending date of the lease term, including any extensions and renewals" or "[t]he date the contractor vacates the property." In addition, the proposal specifies that the "adjusted asset value" at time of disposition for purposes of computing gain or loss is the original asset acquisition cost, less allowable depreciation costs up to the date of the sale and leaseback, and less the depreciation costs that would have been allowed had the contractor retained title up to the time of "disposition" as defined in the proposal. See 68 Fed. Reg. 40467.

Background

Since 1959, the rental cost principle (currently FAR 31.205-36) has provided that rental costs under a sale and leaseback arrangement are allowable only up to the amount that would be allowed if the contractor had retained title ("ownership costs"). See FAR 31.205-36(b)(2). In 1959, and for 10 years thereafter, the cost principles provided that neither gains nor losses arising from the sale or exchange of plant, equipment, or other assets were to be considered in computing contract costs. See, e.g., ASPR 15-205.32; FPR 1-15.205-32.

In 1969, the ASPR Committee published Revision No. 4 to ASPR 15-205.32. For the first time, gains and losses on the disposition of certain depreciable assets were to be taken into account in computing contract costs. This major change in policy was driven by the conviction that contractors employing new accelerated depreciation rules were enjoying huge gains upon disposing of depreciable assets. The regulators felt that, if the government was footing the bill for higher depreciation costs, it should also share in the larger gains made possible by the accelerated depreciation. The primary debate was whether the government should share in all gains (and, to be fair, losses) without limitation, or whether its share of the gain should be limited to the amount of depreciation charged to the government by the contractor.

The final draft of the rule sent to the Assistant Secretary of Defense (Installation and Logistics) for approval in November of 1968 took the approach that the government should share in all gains and losses on disposition of depreciable property regardless of the depreciation charge to the government on such assets. The cover memorandum accompanying the draft rule candidly acknowledged that industry generally opposed the proposal. *See* Memorandum for Mr. Morris, 14 Nov. 1968.* In response to a CODSIA comment, this final draft contained a provision in subparagraph (e) explicitly addressing sale and leaseback arrangements:

^{*}Historical documents cited are in the files of ASPR Case 65-107 received in response to FOIA requests.

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(e) Gains or losses resulting from the sale of property which is leased back shall not be recognized where the resulting rental costs are limited to those of ownership under 15-205.34(c) or 15-205.48(b)(3).

In its memorandum to the full ASPR Committee dated October 7, 1978, the Part 2, Section XV Subcommittee explained that:

A new subparagraph (e) has been added to state that gains and losses resulting from assets which are sold and leased back shall not be recognized where the Government allows only costs of ownership after the transaction. The Subcommittee agrees with CODSIA that it would be inequitable to recognize gains and losses under these circumstances.

The Assistant Secretary of Defense subsequently determined that, as a policy matter, he could not support the approach of sharing "all gains and losses," and he directed the ASPR Committee to reinstate the prior version of the rule which took the "depreciation recapture" approach. See ASPR Committee Minutes, April 23, 1969. The previous draft, dated 26 February 1968, became the final rule on August 29, 1969. Because the previous draft did not include the separate paragraph on sale and leaseback arrangements, this provision did not become part of the final rule.

The Defense Contract Audit Agency ("DCAA") Contract Audit Manual ("CAM") has for quite some time taken the position that:

A gain from the sale of a depreciable asset that is simultaneously leased back under the type of arrangement covered by FAR 31.205-36(b)(2) should not be recognized as a credit to overhead in the year in which the arrangement was transacted. * * * If, at the time of actual disposition of the leased asset, there continues to be a gain or loss associated with the asset, this gain or loss should be recognized.

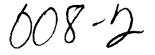
DCAA CAM ¶ 7-208. It is apparent that DCAA's longstanding position on the appropriate treatment of gains and losses in the context of sale and leaseback arrangements is reflected in the proposed rule.

DCAA explained its position in a letter dated October 18, 1993 from Michael Thibault to Ron Solomon of HHS. DCAA's position, Mr. Thibault explained, was

FAR Secretariat (MVA)
Attention: Ms. Laurie Duarte

September 5, 2003

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based on its conclusion that the FAR 31.205-16 requirement to recognize gains and losses from "sale, retirement, or other disposition" of depreciable property in the year in which they occur does not apply to sale and leaseback arrangements (emphasis added). DCAA concluded that a sale and leaseback arrangement is not a "sale" for purposes of FAR 31.205-16 based on its conclusion that the term "sale and leaseback arrangement" as used in FAR 31.205-36(b)(2) refers to a single transaction which is neither a "sale" nor a "lease." DCAA further concluded that a sale and leaseback transaction is not an "other disposition" based on language from the February 26, 1968 subcommittee report (ASPR Case 65-107), in which the subcommittee stated that it added the category of "other dispositions" to "cover such situations as trade-ins or abandonments in place," which would not be covered by the original reference to "sale or retirement" of the property.

To further support its conclusion that a sale and leaseback is not an "other disposition" under 31.205-16, DCAA cited the ASPR subcommittee's conclusion that

Gains and losses resulting from assets which are sold and leased back shall not be recognized where the Government allows only costs of ownership after the transaction. The Subcommittee agrees with CODSIA that it would be inequitable to recognize gains and losses under these circumstances.

DCAA goes on to state in its 1993 letter:

Thus, while the cost principle language does not explicitly exclude the recognition of gains and losses under a sale and leaseback arrangement, the intent of the drafters was clearly established during the deliberations of this cost principle coverage.

Discussion

The proposed change to FAR 31.205-16 would defer recognition of gain or loss on depreciable property in the case of a sale and leaseback arrangement until the later of: (1) termination of the lease; or (2) the date the contractor vacates the property. The rule would measure the contractor's gain or loss as the difference between the fair market value of the property at that time and the "adjusted asset value," defined as the contractor's original asset cost, minus allowable depreciation costs for the period prior to the sale and leaseback, and minus the depreciation costs that would have been allowed had the contractor retained title. Unlike the treatment accorded the simple sale of an asset under subparagraph (c) of the cost principle,

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recognition of gain would not be limited to recapture of depreciation. Rather, the proposal would allow the government to recover a share of market-driven increases in the value of the property occurring both before and after the sale and leaseback transaction, or even increases due to subsequent improvements by the new owner.

The proposed change is also in conflict with the CAS 409 requirement that expressly limits gain recognition to the difference between the original acquisition cost of the asset and its undepreciated balance when there is gain on disposition. By recognizing the full amount of market-driven gain (as well as gain from other causes), and by imputing continued "depreciation" on the asset after it is no longer owned by the contractor, the proposal violates this CAS 409 requirement.

Why there should be such a dramatic difference in treatment of gains and losses due to sales and those due to sale and leaseback arrangements is not explained anywhere in the proposal. Nor does the proposal explain why any gain or loss should be recognized in sale and leaseback arrangements. The drafters of the rule recognized in 1968 that it would be inequitable to recognize gains and loses where the government allows only costs of ownership after the transaction. The proposal fails to address this point at all, a failure that is particularly troubling in light of DCAA's acknowledgement that the clear intent of the drafters was not to recognize such gains and losses. We fail to see any change in circumstances that would undo or mitigate the inequity acknowledged by the drafters in 1968.

The only statement of rationale for the proposed change appears in the preamble to the proposal: "[T]he Government would be precluded from recovering the financing costs that were imbedded in the sales price should the gain be recognized at the date of the sale and leaseback arrangement." See 68 Fed. Reg. 40466. This statement addresses the reason the proposal defers recognition until a later date, but does not address the issue of whether it is equitable to recognize gain or loss at all when the subsequent lease costs are limited to costs of ownership. Moreover, the rationale as stated is somewhat cryptic, to say the least, and leaves the reader wondering exactly what it is that the government would be giving up, that it otherwise would be entitled to, if gain and loss were to be recognized at the time of entering into the transaction. If the comment refers to the possibility that the sales price could be artificially low, in return for lower than market rents for a period of years, it would seem that a rule could be targeted more directly at the understated selling price.

For the foregoing reasons, the Section recommends that, if the proposal is not withdrawn, it be republished as a proposed rule and that the discussion accompanying the proposal address the following three fundamental issues:

FAR Secretariat (MVA) Attention: Ms. Laurie Duarte September 5, 2003

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- 1. In light of the FAR 31.205-36(b)(2) limitation of lease costs in a sale and leaseback arrangement to the costs of ownership, why is it equitable for any gain or loss to be recognized in connection with the transaction?
- 2. Assuming the equity of recognizing gain or loss in connection with a sale and leaseback arrangement can be demonstrated, what reason is there that such gain or loss cannot be recognized at the time of the transaction, perhaps with an appropriate adjustment if the sales price and the subsequent rental cost are both below market?
- 3. In any event, what justification is there for not limiting the amount of gain to be recognized by the amount of depreciation taken?

The Section appreciates the opportunity to provide these comments and is available to provide additional information or assistance as you may require.

Sincerely,

Hubert J. Bell, In./AK.
Hubert J. Bell, Jr.

Chair

Section of Public Contract Law

cc: Patricia H. Wittie
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2002-008-3



September 8, 2003

General Services Administration FAR Secretariat (MVA) Attn: Laurie Duarte 1800 F Street, NW, Room 4035 Washington, DC 20405

Re: FAR Case 2002-0008

Dear Ms. Duarte:

The Aerospace Industries Association (AIA) is pleased to have the opportunity to comment on the proposed revisions to the six FAR cost principles included in FAR Case 2002-0008. AIA member companies support the effort to streamline and add clarity to the cost principles contained in FAR Part 31 and appreciate your proposals in that direction.

Specific comments regarding substantive changes to four of the six principles proposed for revisions are provided as follows.

FAR 31.205-11 Depreciation

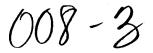
This revision changes the numbering in subparagraph (k) of this principle due to the reordering of the FAR 31.205-26 cost principle. We believe the numbering reference [31.205-26(c)] is incorrect and should read 31.205-26(d). This same reference should also be corrected in the proposed revision to FAR 15.208.

FAR 31.205-16 Gains and Losses on Disposition or Impairment of Depreciable Property or Other Capital Assets

Our member companies have two areas of concern in regards to the new language inserted into this cost principle. The first concern is with the new language "the Government and the contractor shall," which is found with frequency throughout the principle. The necessity for this new wording is not explained and is inconsistent with existing FAR construction. We also believe it alters the relationship of the Government and the contractor because it implies the two parties will jointly take action to implement the principle provisions. We recommend that this terminology be removed wherever it appears.

The second area of concern is the new construction of subparagraph (b) dealing with capital assets subject to sale and leaseback. We believe that inclusion of this paragraph is unnecessary, not reflective of the reality of business situations, potentially inequitable, and not in the interest of either the Government or the contractor. Additionally, the requirements of this section will

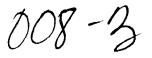
General Services Administration September 8, 2003 Page 2



place a record keeping and reconciliation burden on the contractor that is onerous, complicated and likely to delay contract closings.

The **Attachment** to this letter contains two examples that serve to demonstrate the potential for inequity and dispute in implementing the concept as drafted. Additionally, the following comments are provided for your consideration regarding the new provisions of subparagraph (b):

- 1. The term <u>disposition</u> should only be used in the context of transfer of control over the property in question. Equating disposition to subsequent events, not necessarily under the original owner's control, may lead to confusion and disputes. This provision removes the unambiguous definition of disposal and replaces it with an uncertain and unclear definition.
- 2. The disposition of an asset involves a business decision while the leasing of an asset generally involves a separate business decision. If the asset disposed of requires replacement, that action may be accomplished in a number of ways, e.g., the purchase of a new or used asset, the lease of a different asset or the lease of the same asset. The calculation of the gain or loss on the disposition should not be impacted by whether the contractor intends to continue to use the asset under a different financial model.
- 3. Extension of the disposition date beyond the common use of the term is inequitable because the Government may recoup gains from a contractor that has no gain or may be entitled to a gain in excess of the gain the contractor actually experienced. The two examples in the attachment illustrate the pitfalls of the concept and also point out the complexity involved. The Government should share in the real gains of the disposition, but should not accrue extraordinary gains not actually realized by the transaction. Calculating the recognition of gain based on the value of a building when the contractor vacates is likely to lead to considerable confusion and controversy in cases where the contractor continues to occupy the building for an extended period. In many cases, the new owner makes substantial improvements in the property, which increases the value during the leaseback period. Many times the reason for the sale and leaseback is due to the promise of the new owner to make improvements in order for the seller to stay as a tenant. Other times a sale and leaseback allows a company without ready capital an opportunity to occupy a renovated building that would otherwise be obsolete or inefficient. In these situations, the new asset is dissimilar to the old and the cost comparison loses meaning. Under the proposed regulation the contractor would be penalized at the end of the lease period for subsequent landlord actions that increased the value of the building.
- 4. The proposed regulation may encourage behavior on the part of contractors that is not mutually beneficial to both parties. If the allowability of facility cost is determined based on the contractor's prior ownership, a contractor may be encouraged to expend additional allowable costs to relocate to non-formerly owned facilities.
- 5. Opportunities for conflict and dispute are most likely enhanced by the adoption of the proposed language due to the myriad number of situational possibilities. It is not



- always going to be clear when a contractor has finally vacated a building. In the case of business downturns the contractor may wish to sell the building and lease back a smaller portion. What measure will trigger the disposition? What if the contractor sells the building then leases it back at a later date, supposedly two separate transactions? How long must the contractor vacate the building before leasing in order to preclude classification as a sale and lease back?
- 6. We believe the contractor should recognize a gain or loss on a sale and leaseback transaction immediately upon execution of the change in control. If the contractor has realized a gain, the contractor should be required to share that gain immediately with the Government, as the regulation requires. In exchange for sharing the gain immediately, the contractor should be permitted to recover as an allowable cost the reasonable lease payments on the replacement facility, regardless of whether the replacement facility was previously owned or not. This straightforward approach will permit the timely settlement of the cost in question and result in equity to both the contractor and the Government.

FAR 31.205-24 Maintenance and Repair Costs

We agree that this principle may be deleted because sufficient coverage exists in CAS and GAAP. It follows that the reference to -24 should be removed from 31.205-7 Contingencies.

FAR 31.205-26 Material Costs

The revision deletes two statements in subparagraphs (a) and (c) that deal with the allowability of material costs and the allowability of reasonable adjustments between book and physical inventory. We are concerned that the part of the FAR that delineates allowable versus unallowable cost would omit these statements of material cost allowability, and we believe they should be retained to avoid confusion and disputes.

We concur with the elimination of material cost estimating techniques from subparagraph (d).

Again we commend the Council for the sincere and positive steps proposed to streamline the cost principles and we appreciate the opportunity to provide our comments. If you have questions concerning the comments in this letter, please contact Mr. Dick Powers of my staff on (703) 358-1042. Dick's email address is powers@aia-aerospace.org.

Sincerely,

Robert T. Marlow

Vice President

Government Division

Attachment

Attachment

FAR Case 2002-0008 FAR 31.205-16 Examples

Example 1.	Building original	purchase price	\$80M
		bergreen bries	Ψ O O I I I

Accumulated depreciation \$40M 20 yrsX\$2M

Net Book Value \$40M

Selling price \$60M

Lease payments – 5 year lease \$20M 5yrsX\$4M

Allowable lease cost - \$10M Unallow lease cost - \$10M

Market value at lease end \$70M

Contractor gain - \$70M - \$30M(\$40M NBV-\$10M Dep) = \$40M

Actual contractor gain - \$60M - \$40M NBV - \$10MUnallowable Lease = \$10M

Contractor gain overstated by \$30M

Example 2. Same scenario except

Market value at lease end \$50M

Contractor gain - 50M - 30M(40M NBV - 10M Dep) = 20M

Actual contractor gain - \$60M - \$40M NBV -\$10M Unallowable Lease = \$10M

Contractor gain understated by \$10M